

FINANCIAL PLAN

INTRODUCTION

The foundation for our FY 2012 operating and capital budgets reflects Council's vision of 'one community.' That foundation is supported by additional strategic goals and key objectives, as discussed in the Mayor's and City Manager's budget messages, including the continuation of fiscally sound financial management practices. Glendale's Financial Plan addresses the critical issues that must be addressed with each fiscal year's budget, as well as the strategies that are used to sustain Council's strategic goals while accommodating fluctuations in the economy.

It is critical for a local government to respond quickly and comprehensively to changes in the political and economic environment so that city services are not compromised. The City of Glendale engages in financial planning in order to avoid curtailing basic services or delaying needed infrastructure improvements when revenue sources are adversely affected. The following discussion highlights the principal issues facing the city (operating budget constraints) and the long-term and short-term key strategies for addressing the changing economic and political environment in which we operate.

OPERATING BUDGET CONSIDERATIONS

Operating Revenue Considerations

A city's ability to generate additional revenue from existing sources, or create new revenue sources, is limited by social and economic conditions, state statutes, City Council policies and public sentiment. Municipal tax rates and bonding (borrowing) capacity also are limited by state law and require citizen support and/or voter approval. In addition, some revenues are legally restricted and therefore must be used for specific purposes. Examples of special-purpose revenues include public safety and transportation sales tax revenues, highway user revenue fees (HURF), water, sewer, landfill, and sanitation user fees and development impact fees.

The General Fund covers costs for essential city services like police, fire, parks/recreation, library services and neighborhood preservation, as well as critical support functions like financial and budget management services, human resources and legal services. Many city departments must rely exclusively on General Fund revenues to finance their operating costs, whereas others receive a lesser amount of General Fund financial support.

The city's primary ongoing General Fund revenue sources are state-shared revenues and city sales taxes. These sources typically account for approximately two-thirds to three-fourths of the city's ongoing General Fund revenue budget. State-shared revenues and local sales tax revenues can be sensitive to changes in national, regional and local economic conditions. When the state and local economies are healthy, state-shared and city sales tax revenues normally increase. When the economy enters a downward cycle or recessionary period, these revenue sources could decline, although that is not always the case.

State-shared revenues are comprised of state income tax and state sales tax revenues, as well as state motor vehicle licensing revenue. The state of Arizona distributes to incorporated towns and cities a portion of these state receipts based on each entity's population in proportion to the state's total population of incorporated areas. State-shared revenue is subject to fluctuation due to changes in the economic environment, as well as the political environment, as evidenced by prior legislative discussions to modify the amount of state-shared income tax revenue to be distributed to municipalities. For FY 2012, state-shared revenue is expected to be distributed in the same manner used for the FY 2011 distributions.

For the most part, past reductions in state-shared revenue allocations have been the result of negotiations between the state and the cities. In addition, past reductions occurred with state income tax revenue that provided Glendale and other cities sufficient time to plan for the reduction. Income tax revenue distribution to the cities lags by two years. This means the state income tax receipts for FY 2012 will reflect the income tax the state collected in FY 2010.

Other sources of city revenue, such as property taxes, franchise fees, and development permits and fees, are also subject to external economic and political factors. For example, property tax revenues are dependent on total assessed valuation, appreciation of existing property, and the amount and type of new construction, as well as the property tax rate approved by Glendale's City Council. State limits on property tax rates also constrain the use of this revenue source for General Fund operations. Therefore, we took a prudent approach to projecting these other revenues for FY 2012. A more detailed discussion of these other revenue sources and the projection for FY 2012 is found in the *Budget Revenue Summary* section.

Population Growth

Arizona has experienced phenomenal growth in the past few decades. It is consistently rated in the top tier of the states experiencing the highest levels of growth in the nation. Growth in population is often accompanied by job growth, which is often a reflection of a healthy local and regional economy. A growing population tends to fuel consumer spending as homes are purchased, and consumer goods for those homes are bought. In addition, the state-shared revenues discussed in the previous section are based on a city's population in comparison to the total population, so there is an unintended incentive to encourage population growth in order to receive more state-shared revenue.

Nevertheless, growth is often a double-edged sword. Rapid and prolonged population growth places a great deal of strain on existing resources. This kind of population growth can make it difficult for the city to maintain current levels of services, repair and replace existing infrastructure as it ages and finance future growth-related needs. The city employs various financing strategies and mechanisms to equitably apportion the costs of growth among various sectors of the community, as well as among current and future Glendale residents. The financing strategies include bond financing, development impact fee assessments, and the creation of improvement districts. These are discussed in more detail in the *Ten-Year Capital Improvement Plan* section.

Large, expensive projects like recreation facilities, libraries, water and sewer treatment facilities, and public safety facilities require a long-term commitment of resources for ongoing operating costs of these new facilities. For these kinds of projects, the city staggers the opening of them in order to adequately absorb the additional operating costs that come with their operation. Also, Glendale prefers to use conservative population estimates in its planning process to ensure the revenues needed to operate the facility are available when the project is completed. When unusual growth occurs, the city has several short-term, rapid-impact strategies it can employ to accelerate the provision of services and/or infrastructure development.

Routine Operating Expenses

The cost associated with many routine operating necessities, such as utilities, are continuing to rise. While Glendale has taken a proactive approach to minimizing the impact of such cost increases, some level of cost escalation is inevitable in order to maintain a high level of service for the Glendale community. In developing the operating budget, these routine operating cost increases were at the top of the list of items that had to be addressed before allocating funds for other purposes.

Capital Expense Considerations

Large capital improvement projects take many years to plan, finance and complete. Funds for these projects often will be needed long before the number of residents moving into the area can support the construction costs although it might be several more years before population growth is sufficient to generate the revenue needed for ongoing operating expenses. Under virtually any population growth scenario, traditional bond financing and development impact fee revenues would be hard pressed to keep up with the normal demand for new or expanded streets, storm sewers, fire stations and other facilities.

To meet the need for the construction of new capital facilities, Glendale has pursued some unique partnering arrangements to cover the capital costs. For example, Glendale partnered with the cities of Avondale, Surprise, and Peoria, as well as the Maricopa County Community College District, to enhance the function and value of the Glendale Regional Public Safety Training Facility that opened in FY 2007. The facility currently trains new fire recruits and both police and fire personnel conduct advanced training exercises for the protection of our growing communities. The four partner agencies signed formal, written commitments to share the costs of construction and operations.

Another example of partnership in capital construction is found with the Youth Sports Field facilities just to the east of Glendale's professional sports facilities, the University of Phoenix Stadium and Jobing.com Arena. Both the Fiesta Bowl college football organization and the Arizona Sports and Tourism Authority contributed funds to the construction of this project. Glendale also continues partnering opportunities with local school districts in the construction of parks, playgrounds and sports facilities adjacent to school facilities.

Glendale also assesses development impact fees for commercial and residential construction. These fees are used to supplement property tax revenues for the construction of public safety facilities, parks and recreation facilities, libraries and other capital projects. By using this

approach, the city takes steps to ensure that new developments pay their fair share for the costs associated with the city services needed to support such developments.

Finally, Glendale pursues grant funds to enhance capital projects. Recent examples include state of Arizona Heritage Funds and federal Bureau of Reclamation dollars for parks, trails and open space projects. As a result of these outside grant dollars, the planned capital projects were accelerated and/or expanded to provide better facilities for the Glendale community.

Administering a Sound Financial Plan

If a prolonged economic downturn occurs, and annual revenues cannot support the cost of essential services and infrastructure development, the city's options might include:

- Increasing revenues from existing sources such as sales and property taxes or creating new taxing sources;
- Delaying future growth-related infrastructure development;
- Reducing operating expenses by cutting budgets for city services.

The purpose of a financial plan is to minimize those times when a city must resort to the above alternatives, except in the most extreme circumstances. It also should include short-term financial strategies that are useful in responding to unanticipated budgetary needs of short duration, such as single-year revenue and expense anomalies, damage caused by weather emergencies, or unexpected population growth spurts.

While developing the city's financial plan, it is important to keep the following caveats in mind:

- It is almost impossible to pinpoint service demands and their costs for the distant future;
- The reliability of all predictions will decrease in direct proportion to the increase in the length of the time period involved;
- It is not prudent to make predictions using only a single variable, such as population growth, when other factors, such as economic conditions, play an important role in future events; and
- It is important to design short- and long-term strategies that are flexible enough to meet a broad range of possible outcomes.

LONG-TERM STRATEGIES

Adjusting Staff Levels

Although Glendale has one of the Valley's lowest ratios of city authorized staff positions to population (8.57:1,000) personnel-related costs account for 77% of the city's General Fund operating expenses. The adjustment of staffing levels is an ineffective method for addressing short-term budget deficits because it requires lead-time to implement effectively and it may adversely affect the city's ability to maintain quality services. However, downsizing, when combined with other strategies, can be an effective method of dealing with prolonged economic slowdowns.

The City of Glendale's leadership team carefully reviews every new position request. When a new position is needed to provide new or expanded services, both the initial (one-time) and ongoing costs associated with providing and maintaining the service must be included with the position request. These procedures help ensure that added services and positions will be sustainable in future years.

Alternatives to Permanent Staff Increases

The selective use of temporary and contract workers is one of several useful alternatives to meeting predictable but time-limited workload increases without adding regular status employees. It is important to have a definitive policy that limits the length of time a position can be filled by a temporary employee. It also is important to closely monitor the time limit to ensure compliance with the policy.

One example of the selective use of temporary employees deals with the staffing of polling sites during city elections. The city's equalization strategy dictates that the predictable costs for these workers be budgeted as an ongoing operating expense spread evenly between election and non-election years. Another example of the selective use of contract employees is the establishment of contract positions for building inspections services at the construction sites for the intense development at Westgate. These contract positions expired once the construction activity was materially complete.

In some cases, contracting for outside services can be less expensive than adding permanent staff to provide selected city services. A further advantage is that it is faster and easier to vary contract amounts on a year-to-year basis than it is to manipulate permanent staffing levels and overhead costs for equipment and building space. For these reasons, Glendale has placed increasing emphasis on negotiating service contracts for areas like parks landscape maintenance, custodial cleaning of city facilities, and specialized legal work.

Equalizing Predictable Expenses

Two additional strategies the city uses to moderate peaks in ongoing expenses are

- the spreading of routine periodic expenses over multiple budget years; and

- the pre-funding of replacement equipment such as vehicles and technology equipment (e.g., PCs, servers, etc.) through a rental rate structure that spreads the cost of the replacement over several years.

As noted earlier in this discussion, the City Clerk's Office accrues half of the next election cost in the non-election year to reduce biennial election expense peaks. This amount is carried over and added to an equal amount that is budgeted in the actual election year. Although election expenses will continue to rise as our voter population increases, this practice of dividing known costs across several years substantially levels out the expense curve for scheduled elections. As a result of this approach, the need for one-time election appropriations every two years has been eliminated, leaving only special election expenses, such as bond elections—which occur infrequently—to the one-time budgeting process.

Prior to the implementation of the technology and vehicle replacement programs, the city's ability to replace city vehicles and technological equipment cycled up and down with the local economy. In lean years, urgently needed replacement equipment was purchased at the expense of capital projects or the operating budget. Then, when economic conditions improved, the city would engage in massive "catch-up" efforts.

To eliminate this problem, the replacement funds were designed to allow the city to replace outdated, or worn out equipment at regular intervals. Two replacement fund line items were added to each department's annual operating budget to accrue funds for vehicle and technology replacements, respectively. Experience has shown that many vehicles are not replaced as originally scheduled because of low mileage or good maintenance history, and we expect that experience will continue into the future. In these cases, we extend the useful life of the vehicle. Nevertheless, we closely monitor this replacement fund to ensure that it provides sufficient funds to replace essential vehicles and equipment as needed.

The technology replacement fund balance not only covers the systematic replacement of desktop computers, but also annual software licensing costs for a wide range of software used in city operations, virus and security maintenance costs, citywide data storage, database servers, and cable/video equipment and presentation systems. As is the case with the vehicle replacement fund, experience has shown that the useful life of some technology equipment can be extended and thus the fund accumulates a level of reserve funding which is used for emergency replacements and/or upgrades to existing inventory.

Capital Improvement Plan Development

Conservative population and revenue growth projections are used for long-range capital planning to determine when, where, and how capital projects will be implemented because most large capital construction projects permanently increase the city's ongoing operating costs for staff, maintenance, repair, utilities, etc. For example, the operating budget impact of the Foothills Library and the Downtown Civic Center, both of which opened in the 1990s, were carefully considered prior to initiation of these projects to ensure revenue growth would cover the increased operating costs. Glendale also analyzes the long-term financial projections of debt service costs prior to every bond sale.

Major capital projects can be planned, scheduled, and financed in ways that will not deplete needed resources from the annual operating budget or require an increase in Glendale's secondary property tax. Short-term financial strategies, such as various financing instruments or the acceleration or deceleration of project schedules, can help us meet unusual population growth or service demands. The introduction to Glendale's *2012-2021 Capital Improvement Plan* provides an explanation of the capital project process.

Property Tax Stabilization

For over a decade, Council policy has been to stabilize the property tax rate and structure at reasonable levels so that property tax revenue is sufficient to meet long-term, foreseeable revenue needs without requiring intermittent adjustments. Capital improvement projects are planned, financed and scheduled for implementation so that the secondary property tax rate can remain relatively stable over the coming decade.

Arizona's property tax levy consists of two tiers. The primary property tax levy has state-mandated maximum limits, but it can be used by a city for any lawful purpose. The primary property tax revenue is included in the General Fund. However, because Glendale has minimized its use of the primary property tax levy, this revenue source is expected to be less than 3% of the city's anticipated General Fund revenues in FY 2012.

The secondary property tax is an unlimited levy that can be used only to retire the principal and interest on a municipality's General Obligation bond debt. This revenue source provides more 'bang for the buck' because it can be leveraged to borrow more funds to pay for capital projects. Therefore, the secondary property tax levy is optimized in relation to the primary property tax levy.

Although many cities in other parts of the country use the property tax rate to make short-term operating budget adjustments, changes in Glendale's tax structure or rates are viewed as long-term financial strategies. Arizona's tax limitation statute, the relatively minor role of primary property tax revenue on Glendale's operating budget, and the city's property tax stabilization policy combine to make property tax adjustment an ineffective short-term strategic tool.

As a practical matter, it might take up to a year for a property tax change to be implemented and longer to produce a significant increase in revenues. Growth in the tax base and changes in the assessed valuation rate determined by the county often have a larger impact on the level of revenues raised through property taxation.

Given these facts, increasing Glendale's property tax rate is a more appropriate alternative for addressing a chronic structural imbalance between revenues and expenses than for balancing a single year's operating budget. For example, when the city reaches full build-out much less revenue will be generated from new tax base growth. If this decrease were not accompanied by sufficient growth in assessed valuation or offset by increases in other revenues or a reduction in operating expenses, a serious imbalance might occur that might trigger a property tax increase.

As noted above, secondary property taxes are used to repay voter-authorized General Obligation bond debt. With efficient scheduling of bond sales and capital projects, the *Ten-Year Capital Improvement Plan* is designed to keep the secondary property tax rate level. Changes in capital construction schedules, interest rates and several other variables might necessitate a property tax rate adjustment over the longer term; however, most of these situations can be addressed by fine-tuning the primary tax rate and directing the flow of interest earnings on bond proceeds between construction and debt service funds.

SHORT-TERM STRATEGIES

The following short-term financial strategies play an important role in: (1) maintaining the delicate year-to-year equilibrium between revenues and expenses; (2) responding to temporary changes in economic conditions; and/or (3) absorbing or avoiding anticipated revenue shortfalls.

Sales Tax Stabilization

Sales tax revenues fluctuate and are subject to sudden economic changes like a sudden downturn in the economy, as occurred after September 11, 2001. Prior to FY 2004, Glendale's stabilization policy required the use of the actual amount of sales tax revenue collected in the prior twelve months as its sales tax revenue base estimate for developing the next year's operating budget, with no growth rate factor for budgeting purposes.

This conservative approach to estimating sales tax revenue minimized the likelihood that annual budgeted operating expenses would significantly exceed actual sales tax revenues in any given year. In fact, actual receipts usually were higher than the prior year because tax revenue increases were attributable to growth in the tax base (i.e. population growth). When actual receipts exceeded the base estimate, excess revenue was applied to the operating capital budget or used to increase the city's GF fund balance.

For the FY 2004 budget, a different approach was taken to establishing the FY 2004 revenue budget for city sales tax receipts. The FY 2004 revenue budget for city sales taxes included a full year of estimated sales tax receipts from new development that was expected to open by the start of FY 2004 or shortly after the start of the fiscal year. This approach was taken to avoid severely impacting service levels as a result of sluggish growth in state shared revenues. For the FY 2005 through FY 2008 budgets, this approach was further modified to allow the city sales tax projection to match the previous year growth percentage because this revenue source had performed so strongly.

The severe economic downturn between FY 2009 and FY 2011 required city sale tax projections to mirror the negative decline in sales tax receipts that cities and towns were experiencing throughout the nation. With the economic downturn leveling off, the city sales tax projection returned to the approach discussed previously and used from FY 2005 through FY 2008. This approach requires the city to look at the most recent sales tax activity and only build in a growth percentage that matches the way city sales tax revenues are trending for that time period.

Operating Capital Management

Operating capital is often referred to as "pay-as-you-go" capital because projects and equipment in this category are funded directly from operating revenues. Operating capital is used to pay for

- building maintenance and replacement items such as air conditioners, roofing, and floor furnishings,
- specialized equipment not in the vehicle replacement program, such as sanitation trucks and street resurfacing vehicles, and
- selected routine infrastructure maintenance activities such as the street resurfacing program.

In addition, the initial purchase of a vehicle is funded with operating capital. For example, if a new inspector position is approved for the Building Safety Department, that inspector will need a vehicle. The initial purchase of the new vehicle for the new inspector position is funded with operating capital because it is an addition to the city's fleet (versus a replacement). Subsequent replacement of that vehicle is then funded through the vehicle replacement program.

Unlike personnel costs, it is relatively fast and easy to make adjustments to operating equipment budgets without reducing the city's service capacity or quality. Adjustments to the rate at which operating capital is spent can function as an effective short-term shock absorber to level out temporary revenue fluctuations. Glendale residents will not be materially affected if city fleet vehicle replacements are delayed or accelerated in a single budget year, as long as the replacement program continues and repair and maintenance costs for these vehicles are not unreasonable. For example, delaying a portion of the street resurfacing program in one year does not have major negative consequences if the program is accelerated in the following year.

An ongoing, stable revenue source is much less critical for operating capital than it is for maintaining service levels for police, fire and emergency services. It is important to keep in mind that maintaining adequate operating capital levels and adjusting the rate of capital spending minimizes the need to reduce the operating budget or deplete other fund resources. When possible, operating capital budgets are restored before any new programs or employees are added to the ongoing budget.

Building and Maintaining Adequate Fund Balance

By law, Arizona cities are required to prepare and operate under a City Council-approved balanced budget that must be filed annually with the state's Auditor General. City government is prohibited from spending more than the total amount appropriated in its annual budget document. This limitation raises several interesting questions about how the city can successfully maintain an annually balanced budget in years when General Fund revenue deficits or surpluses occur.

General Fund revenue surpluses accrued in one year can be reserved and used to offset revenue deficits that might occur in a subsequent year. The accounting mechanism Glendale uses to reserve General Fund surplus revenues is referred to as the General Fund's fund balance. Every fiscal year, a portion of fund balance is established as a General Fund contingency appropriation. A similar contingency appropriation is established each year for other city funds like the

enterprise operations (e.g., sanitation fund and landfill fund). This mechanism enables the city to meet the legal constraints of a balanced annual budget and provides a source to address emergencies and other unanticipated expenses.

Like operating capital, fund balance can function as a financial shock absorber to smooth out short-term revenue and expense fluctuations. When sluggish economic conditions result in lower-than-projected revenues, a portion of fund balance can be allocated to cover budgeted operating expenses. When the economy is healthy, and revenues are higher than predicted for annual budgeting purposes, the excess revenues can be added to the fund balance for future use.

City Council policies discourage the routine use of fund balance to support long-term or ongoing expenses in the operating budget. The City's financial policy requires the city's contingency appropriation be equal to 10% of General Fund revenues. If fund balances are used for one-time projects, restoring them becomes the highest budgeting priority after assuring that adequate operating funds are available to support essential services and infrastructure needs.

The sales tax stabilization strategy produces a domino-like effect that supports the city's ability to maintain adequate fund balance during times of high revenue growth. Conservative revenue estimates result in conservative annual budget estimates. Conservative budget estimates limit growth in non-essential operations, and this practice permits a portion of the excess sales tax revenue to be allocated to contingency reserves. These reserves can offset drops in other revenue tax sources, such as building permits, or augment sales tax revenue when unpredictable downturns occur. Once reserves reach the 10% of revenues target level, any further amounts are usually added to the operating capital budget.

Fund-related financial information is summarized in Schedule One, which is entitled Fund Balance Analysis. Detailed descriptions of each fund in Glendale's financial system, including the General Fund, enterprise funds and special revenue funds, are contained in the *Budget Summary* section of this document.

CONCLUSION

During the economic downturn that began in late 2001 and continued through early 2003, Glendale employed some of the short-term strategies outlined in the previous sections. By FY 2006, it was clear that the economy had rebounded. The record setting growth that we experienced during this time ended during FY 2008. In order to deal with this most recent slowdown in the economy, we have continued to follow many of the cost-saving measures that were implemented in FY 2003, including

- No transfers of salary savings to operating budgets except in very limited instances.
- Non public-safety staffing positions are reviewed by upper management to make sure they still are serving current business needs and demands as they become vacant before the recruitment process actually begins for those positions.

- No unbudgeted carryover savings – all carryover will be returned to the General Fund
- Capital projects are reviewed for all operating and maintenance costs impacting the General Fund

These strategies, coupled with prudent budgeting practices, allowed Glendale to deal with the recent economic downturn without severely hampering current services and programs. Continuation of these strategies will see us through the future.